

ISSUE DATE: June 5, 2000

DOCKET NO. E-002/M-00-174

ORDER APPROVING A CUSTOMER BUYBACK PROGRAM

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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In the Matter of the Petition of Northern States
Power Company for Approval of a Customer
Buyback Program

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PROCEDURAL HISTORY

On February 10, 2000, Northern States Power Company (NSP) filed a petition seeking Commission approval of a customer buyback program.

Comments were filed by the Department of Commerce (DOC) on March 20, 2000, and by the Office of the Attorney General, Residential & Small Business Utilities Division (OAG-RUD) on March 28, 2000.

On March 31, 2000, NSP filed reply comments.

On April 3, 2000, the OAG-RUD filed a request for supplemental comments due April 21, 2000.

Supplemental comments were filed on April 21, 2000, by the OAG-RUD and NSP.

On May 4, 2000 the petition came before the Commission.

FINDINGS AND CONCLUSIONS

I. NSP's Customer Buyback Program

On February 10, 2000, NSP petitioned the Commission for approval of a "customer buyback program" which would, in certain circumstances, allow a customer who is able to reduce its load by at least one megawatt to choose to interrupt its use of electricity in exchange for a payment based on relevant market prices for the energy the customer did not use. In this way NSP "buys back" from the customer the energy the customer did not use. The customer may reduce its demand below its usual level by cutting load or switching to backup generation, or both.

NSP proposed that the operation of this program be limited to exceptional situations, when enough

lead time is available to reach agreement with customers on specific terms, such as summer periods of extreme temperature and humidity conditions and significant and extended difficulties with regional generation or transmission systems.

The customer buyback program uses an enabling agreement to establish the general terms for purchases, which apply to all participating customers at all times. The enabling agreement expedites the purchase process by leaving only specific terms (e.g. price) to be determined before a specific buyback period. Customers that have an enabling agreement with NSP have the option, but not an obligation, to sell energy to NSP during any buyback period. The enabling agreement provides the procedures for establishing the price and quantity for a specific energy purchase by NSP. The program requires a minimum load reduction of one MW.

NSP will notify eligible customers of the date and time of a scheduled buyback period. Customers may then volunteer to participate in any specific buyback period by providing NSP an offer that includes the amount of load reduction and a selling price. NSP would then have the opportunity to accept, reject or make a counteroffer. Alternatively, NSP could provide a purchase price and the customer would have the opportunity to accept, reject or counteroffer. The program would enable NSP to purchase additional load management from customers at or below market prices. If NSP reaches agreement with an individual customer on an offer, compensation is determined by applying the accepted price to the measured load reduction during the buyback period according to the terms of the enabling agreement.

NSP plans to include the cost of energy purchased from the customer buyback program in the fuel clause adjustment, when such costs are less than those available from the wholesale market. By doing so, these costs will flow through the fuel clause adjustment directly to the customers' bills. NSP revenues will be reduced by the amount saved through the buyback program to the extent these savings are reflected in lower monthly fuel clause adjustments. Additionally, a minimal revenue reduction will result from NSP buyback purchases that reduce sales to participating customers.

NSP indicated that a primary benefit of its proposal was to reduce total energy supply costs by replacing higher priced wholesale purchased power resources with lower priced retail purchased power resources. The program has been designed to do this only during exceptional periods that are normally characterized by what has been referred to as "price spikes" that can occur in the wholesale market.

II. Position of the Parties

A. Department of Commerce (DOC)

The DOC concluded that the proposed program would provide immediate benefits to all customers. All customers would benefit because the fuel clause adjustment would decrease as lower-price retail energy buybacks replace higher-price wholesale energy purchases.

The DOC expressed concern with the proposed accounting treatment and the potential environmental impact of the additional on-site diesel generation that may result from this program.

The Department reviewed the appropriateness of the cost of the energy purchased through this program flowing through the fuel clause adjustment directly to the customer's bill and concluded that recovery through the fuel clause was appropriate. The effect of the program would be that

energy would be purchased from one retail customer for resale to another retail customer. The DOC concluded that this transaction could reasonably be seen as electricity purchased for resale. In the proposed program customers would be eligible for the program provided they agreed to reduce demand by one MW. Payments to customers were to be based on the amount of the customer's actual energy reduction and on this basis recovery through the fuel adjustment clause would be appropriate.

The DOC concluded that an increase in diesel generation may be realized as a result of this program. Although NSP argued that any such increase would be minor because the number of buyback hours will be small and that customers with on-site diesel generation were likely to already participate in NSP's interruptible rate program with high levels of credit, the Department believed that further exploration of this issue was warranted. For this reason, the DOC believed that an environment-related reporting requirement would be useful. The DOC recommended a compliance filing be made by NSP by November 1, 2000 reporting:

- the amount of energy purchased from retail customers,
- the savings the customers received from the purchases, and
- an estimate, on a daily basis, of the portion of the energy purchased from retail customers that was replaced by diesel generation.

III. Office of the Attorney General, Residential & Small Business Utilities Division (OAG)

The OAG generally supported the concept of NSP's buyback program. The OAG saw this program providing needed demand reductions in times of supply shortages and also providing an opportunity for a real-time customer response as electricity prices increase.

The OAG noted that buyback programs may also provide an antidote to a potential exercise of market power. The OAG cited a Department of Energy (DOE) report ¹ suggesting that U.S. utilities with high market share and limited available transmission capacity into their region may be able to exercise market power by strategic bidding and other means of withholding power at times of high demand. At times of high demand, even the withholding of a small amount of power from the market could drastically increase market prices. The DOE report recommended buyback programs as one possible regulatory means to limit such market power.

The OAG cited NSP's testimony before the Federal Energy Regulatory Commission (FERC) in its pending merger with New Century Energies that showed that NSP has a market share of 62% when summer prices are above \$100 per MWh.²

The OAG indicated that buyback programs can make it less attractive for utilities to withhold power for two reasons. First, the reduction in demand that occurs through a buyback program as a

¹ Horizontal Market Power in Restructured Energy Markets, DOE/PO-0060. Office of Policy, U.S. Department of Energy, March 2000.

² NSP merger testimony before FERC, Direct Testimony and Exhibits of William H. Hieronymus, Exhibit No. ____ (WHH-19), page 2.

result of high prices can offset the impacts of any hoarding capacity, thus countering a utility's ability to drive prices upward through capacity hoarding. Second, the need to pay high prices to customers reduces the incentive a utility might have to increase prices in the first place. The OAG stated concern that NSP's plan to recover the costs of the buyback from all customers through the automatic fuel adjustment clause will dilute NSP's disincentive to exercise market power. To the extent that NSP can pass the costs of the buyback program through the fuel clause, the disincentive for NSP to use its market power that might be created by such a buyback program would be diluted.

For these reasons, OAG recommended in its comments of March 28, 2000, that the Commission review the costs associated with the buyback program separately from the normal fuel clause review under Minnesota Rules.³ The OAG recommended that this separate review should ascertain whether NSP's costs incurred under the program were prudent and reasonable, including whether wholesale prices were in any way influenced by the withholding of capacity from the market or other anti-competitive activity.

The OAG also supported the reporting requirements proposed by the DOC. Further, both the DOC and the OAG supported a requirement that NSP provide additional information to allow the Commission to determine if the FCA has been properly credited for the cost of off-system sales during the period that buybacks were occurring. The recommendation was that this information should include:

- next day operating plan specifically identifying off-system sales, and actual off-system sales for that day during a buyback period;

- prices received for off-system sales;

- fuel clause related costs allocated to off-system sales.

In comments of April 21, 2000, the OAG made revisions to its earlier comments and recommended that the proposed buyback program be approved as a one year pilot program. The OAG specifically asked that NSP be required to:

- provide sufficient information to demonstrate that any price NSP pays to large customers through the program is reasonable in light of supply-side alternatives available at the time the buyback program is exercised. This information should be provided and analyzed prior to any recovery through the fuel clause;

- provide data that illuminate the relationship between energy-related costs recovered through the fuel clause (including supply-side and demand-side costs) and wholesale market revenues that may be derived from reselling the same energy.

³ Minn. Rules Part 7825.2900

The OAG noted that the first category of information, above, was necessary to help ensure that the buyback program does not burden customers with demand-side resources that cost more than available supply side resources. Once this information was reviewed, the OAG recommended that the Commission allow recovery of reasonable and prudent pilot program costs through the fuel clause.

The second category of information would be helpful in evaluating the buyback program as a whole. The OAG, however, indicated that recovery through the fuel clause should not be conditioned on the review of this information.

The OAG further recommended that NSP explore small customer buyback programs, including exploring the Wisconsin Electric Power "Dollars for Power" program for small business electricity consumers, and report on the feasibility and proposed design of such a program at the end of this year's pilot program.

Although The OAG in its later comments expressed continuing concern about the ability of vertically integrated monopolies to influence wholesale energy prices, the OAG made no recommendations for additional filing requirements.

IV. NSP

NSP did not object to providing the information recommended by the DOC but NSP indicated concern about the feasibility of acquiring information on the portion of the repurchased energy replaced by diesel generation. NSP indicated it had limited access to information about the amount of diesel energy produced by customer operation of diesel generation and was concerned about being able to determine how much of that generation was attributable to energy provided by NSP during a buyback. NSP, however, did not object to attempting to obtain such information through customer requests.

In response to concerns expressed by the DOC and OAG, NSP offered to report for each specific day in which a customer buyback takes place the following information:

- the hourly schedule of energy purchased from each buyback customer,

- the agreed to price paid to each buyback customer for their energy,

- the expected range of energy prices when the decision was made to purchase energy from the buyback customers,

- a representative after-the-fact market price of the energy during the period of the buyback,

- the maximum amount of energy that could have been provided by diesel generation during the buyback period (based on customer provided information),

- the actual amount of energy that was provided by diesel generation during the buyback period (if known).

NSP agreed to a review of the buyback program costs as suggested by the DOC but argued that all

prudently incurred costs should be included in the FCA in a timely matter. NSP indicated that for it to make the most economic decisions based on the cost of energy, the energy purchases from the buyback program should be treated in the same manner as energy purchases from any other energy supplier. If there was uncertainty placed on the energy purchases from this program, NSP would have no reason to buy under these circumstances, when it could purchase the higher cost energy from the wholesale market without the uncertainty of cost recovery.

NSP agreed, in principle, that the buyback concept could apply for smaller business customers. NSP, however, stated that it would need differently designed buyback programs for different size customers. NSP indicated its willingness to work on developing a smaller customer specific buyback program.

NSP indicated that the buyback of energy under the proposed program would occur only after all other available interruptible load had been curtailed. NSP, however, indicated the need to retain some flexibility to use load management resources in a way that best met the needs of the system. To allow the Commission and parties to determine if NSP used the proposed buyback program after curtailing all other controllable load, NSP proposed providing daily log sheets of actual interruption steps taken on buyback days.

NSP proposed clarifying language in its Enabling Agreement to reflect that the most likely use of the customer buyback program would be during exceptional weather conditions when the cost for energy in the wholesale market will be at its greatest. It was NSP's expectation that customers participating in the buyback program would be paid a price per MWh that would be less than the market rate except if the buyback was due to significant and extended difficulties with regional generation or transmission systems.

NSP agreed to file the Enabling Agreement and Energy Purchase Agreement for this program as an amendment to the tariff book. NSP has also agreed to notify the Commission and the DOC prior to, when possible, and immediately after the Company operates the buyback program.

V. Commission Action

The Commission agrees with the DOC and the OAG that the buyback program as proposed by NSP could be beneficial to the Company and to all of its customers by encouraging the buying back of lower priced energy from certain customers to replace higher-price wholesale energy costs. Further, the Commission supports the increased demand side management which this program encourages. The Commission agrees that this program should be approved on a one year experimental basis with the reporting requirements recommended by the DOC, the OAG and agreed to by NSP and the Commission will so order.

The Commission has further considered the issue of the appropriateness of NSP including the cost of energy purchased from the customer buyback program in the FCA. This will be discussed below.

A. Statutory Authority

Minn. Stat. § 216B.16, subd. 7 provides for automatic adjustments as follows:

Energy cost adjustment. Notwithstanding any other provision of this chapter, the commission may permit a public utility to file rate schedules containing provisions for the automatic adjustment of charges for public utility service in direct relation to changes in: (1) federally regulated wholesale rates for energy delivered through interstate facilities; (2) direct costs for natural gas delivered; or (3) costs for fuel used in generation of electricity or the manufacture of gas.

The Commission has reviewed the question of whether the cost of energy purchased from the customer buyback program is properly recovered by NSP through the FCA and finds that the proposed buyback costs are directly related to changes in federally regulated wholesale energy rates for energy delivered through interstate facilities within the meaning of those terms in Minn. Stat. 216B.16, subd. 7 (1). As such, the Commission is not prohibited by statute from allowing, but is not required to allow, the Company to do so.

B. Variance to Minn. Rules

Minn. Rule, Part 7825.2400, subp. 7 defines the scope of permissible costs included in the “cost of energy purchased.” The definition, as written, is ambiguous as to whether it includes the costs associated with the customer buyback program contemplated herein. Minn. Rule, Part 7825.2500A also is unclear as to the inclusion of these costs.

Minn. Rules, Part 7829.3200 provides that the Commission will grant a rule variance if it finds that enforcement of the rule would impose an excessive burden on anyone, that granting the variance will not adversely affect the public interest, and the variance would not violate any standard imposed by law.

Excessive Burden: Enforcing these rules would put an excessive burden on the Company as well as ratepayers by limiting flexibility in addressing supply and cost of supply problems which may arise in extreme or emergency situations. Enforcement of the rules would put a burden on customers if the least cost source of energy was not made available to them.

Public Interest: Granting the variance would not adversely affect the public interest because the outcome of the buyback program would generally be to increase resource options in situations of short supply while minimizing the cost of those resources.

No violation of a Standard Imposed by Law: The variance does not conflict with any standard imposed by law. As noted earlier in this order, Minn. Stat. § 216B.16, subd. 7 does not prohibit the Company’s proposed buyback program.

Having considered this matter, the Commission will grant the rule variances requested and require NSP to file a compliance report by December 1, 2000, on its activities under the buyback program. The specific requirements to the compliance report will be described in detail in the ordering paragraphs that follow.

Further, the Commission will grant provisional recovery of costs through the FCA prior to review of the required compliance report.

The Commission accepts the clarifications and proposals agreed to by NSP as set forth in the Ordering paragraphs that follow.

ORDER

1. NSP's customer buyback program is approved and effective as a pilot program for the summer of 2000, as of the date of this Order.
2. NSP shall file a compliance report by December 1, 2000. The compliance report shall include:
 - A. the hourly schedule of buyback energy purchased from each customer;
 - B. the agreed to price paid to each buyback customer for their energy;
 - C. the expected range of energy prices when the decision was made to purchase energy from the buyback customers;
 - B. a representative after-the-fact market price of the energy during the period of the buyback;
 - C. the maximum amount of energy that could have been provided by diesel generation during the buyback period (based on customer provided information);
 - D. the actual amount of energy that was provided by diesel generation (if known);
 - E. next day operating plan for the current day, specifically identifying projected off-system sales and purchases, and actual off-system sales and purchases for the current day during a buyback period;
 - F. prices received for off-system sales during a buyback period;
 - G. fuel clause related costs allocated to off-system sales during a buyback period.
3. The following variance is hereby granted for a one year period, effective on the date this Order is issued:

Minn. Rules, Part 7825.2400, subp.7 is varied so that for a period of one year from the date of this Order, the rule will apply in this matter as follows:

Subp. 7. Cost of energy purchased. “Cost of energy purchased” is the cost of purchased power and net interchange defined by the Minnesota uniform system of accounts, class A and B electric utilities, account 555 and purchased under federally regulated wholesale rates for energy delivered through interstate facilities and cost of energy purchased through the Customer Buyback Program. All electric public utilities shall use this definition regardless of class.

4. The following additional variance is granted for a one year period, effective on the date this Order is issued:

Minn. Rules, Part 7825.2500 A is varied so that for a period of one year from the date of this Order, the rule will apply in this matter as follows:

Changes in cost resulting from cost of energy purchased through the Customer Buyback Program, and changes in the federally regulated wholesale rate for energy purchased and changes in the cost of fuel consumed in the generation of electricity. This provision is entitled electric energy adjustment.

5. NSP is granted provisional recovery, through the Fuel Clause Adjustment, of the costs of the buyback energy purchased prior to a review of the compliance report described in Ordering paragraph 2, above.
6. The Commission adopts NSP’s proposal to explore small customer buyback programs, including the Wisconsin Electric Power program referenced in the OAG reply comments, and to report on the feasibility and proposed design of these programs by March 1, 2001.
7. The Commission adopts NSP’s proposal to file the daily log sheets of actual interruption steps taken on buyback days.
8. NSP shall file the Enabling Agreement and the Energy Purchase Agreement for this program in standard form as an amendment to its tariff book.
9. NSP shall amend the last sentence in its “Acceptance of Offers” section of the Enabling Agreement to read as follows:

Company will normally accept offers expected to minimize energy supply costs and will not accept offers that do not decrease energy supply costs except in the event of significant and extended difficulties with regional generation or transmission systems.

10. NSP shall notify the Commission and the DOC prior to, and immediately following, an exceptional period during which the Company operates its buyback program. Prior notification may be by phone or fax to be followed by written notification to the Commission and the DOC within five days of the end of the buyback period. Notification of the times and periods over which the buybacks occur shall be sufficient.
11. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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